

D.T.E. 99-29

Petition of Western Massachusetts Electric Company for Approval of Asset Divestiture.

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FOR: WESTERN MASSACHUSETTS ELECTRIC

LIGHT COMPANY

Petitioner

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FOR: CONSOLIDATED ENERGY EDISON MASSACHUSETTS, INC.

Intervenor

## I. INTRODUCTION

On March 4, 1999, Western Massachusetts Electric Company ("WMECO" "Company") filed a petition with the Department of Telecommunications and Energy ("Department") for approval of the sale of substantially all of its non-nuclear generating assets to Consolidated Edison Energy, Inc. ("CEEI").<sup>(1)</sup> CEEI will in turn assign the purchase and sale agreement and the related agreements to Consolidated Edison Energy Massachusetts, Inc. ("CEEMI"), a wholly-owned subsidiary of CEEI (Tr. at 6). WMECo also asks the Department to make certain findings concerning the assets as eligible facilities for Exempt Wholesale Generator ("EWG") status. The matter was docketed as D.T.E. 99-29.

CEEMI sought intervenor status on April 1, 1999, and was granted full participant status on April 12, 1999. The Attorney General of the Commonwealth ("Attorney General") filed a notice of intervention as of right, pursuant to G.L. c. 12, § 11E.

On April 14, 1999, the Department held a procedural conference during which the Attorney General raised issues regarding the scope of the proceeding. The parties were in disagreement as to whether the scope of the proceeding should properly encompass the "inflation adjustment" rate increase that the Company seeks to deduct from the net proceeds of this divestiture, as well as ratemaking treatment of the sale proceeds. The

Hearing Officer requested that the parties submit briefs on the issue. On May 6, 1999, the Hearing Officer issued a ruling, stating that the scope of the proceeding would be limited only to the Company's request for approval of the divestiture and EWG status. Western Massachusetts Electric Company, D.T.E. 99-29 (Hearing Officer Ruling at 5-6 (May 6, 1999)). Pursuant to notice duly published, a hearing was held at the Department's offices on May 18, 1999.

## II. STANDARD OF REVIEW

The Legislature has vested broad authority in the Department to regulate the ownership and operation of electric utilities in the Commonwealth. See, e.g., G.L. c. 164, § 76; D.P.U./D.T.E. 97-111, at 17. The Department's authority was most recently augmented by the Restructuring Act.<sup>(2)</sup> Boston Edison Company, D.P.U./D.T.E. 96-23, at 9 (1998). The Restructuring Act requires that each electric company organized under the provisions of Chapter 164 file a plan for restructuring its operations to allow for the introduction of retail competition in generation supply in accordance with the provisions of Chapter 164. G.L. c. 164, § 1A(a). Among other things, the Restructuring Act requires that all restructuring plans contain a detailed accounting of the company's transition costs and a description of the strategy to mitigate those transition costs. Id. One possible mitigation strategy is the divestiture of a company's generating units. G.L. c. 164, § 1.

In reviewing a company's proposal to divest its generating units, the Department considers the consistency of the proposed transactions with the company's restructuring plan, or in some cases the company's restructuring settlement, and the Restructuring Act. A divestiture transaction will be determined to be consistent with the company's restructuring plan or settlement and the Restructuring Act if the company demonstrates to the Department that the "sale process is equitable and maximizes the value of the existing generation facilities being sold." G.L. c. 164, § 1A(b)(1). A sale process will be deemed both equitable and structured to maximize the value of the existing generating facilities being sold, if the company establishes that it used a "competitive auction or sale" that ensured "complete, uninhibited, non-discriminatory access to all data and information by any and all interested parties seeking to participate in such auction or sale." G.L. c. 164, § 1A(b)(2).

The Restructuring Act provides that all proceeds from any such divestiture of generating facilities "that inure to the benefit of ratepayers, shall be applied to reduce the amount of the selling company's transition costs." G.L. c. 164, § 1A(b)(3). Where the Department has approved a company's restructuring plan or settlement as consistent or substantially compliant with the Restructuring Act, the Department will approve a company's proposed ratemaking treatment of any divestiture proceeds if the company's proposal is consistent with the company's approved restructuring plan or settlement.

The Department notes that issuance of an initial order approving a company's restructuring plan, subject to further review and reconciliation, has been authorized by the Restructuring Act. G.L. c. 164, § 1A(a). On February 20, 1998, the Department issued its Initial Order on WMECO's Restructuring Plan. Western Massachusetts Electric

Company, D.T.E 97-120, (1998).<sup>(3)</sup> In that Order the Department noted that WMECo planned to divest its non-nuclear generating resources through a competitive bid process. Id. at 6, 13.

### III. DESCRIPTION OF ASSET DIVESTITURE

#### A. Overview

The Company states that 290 megawatts ("MW") of its non-nuclear generating assets ("Assets") were proposed for sale in this divestiture, consisting of the following facilities: (1) West Springfield Station, a 209 MW fossil fuel facility in West Springfield and Agawam; (2) three internal combustion units, located at WMECO's West Springfield (22.0 MW), Doreen Street (21.1 MW), and Woodland Road (20.4 MW) substations; (3) the Gardner's Falls Project, a 3.7 MW hydroelectric facility located on the Deerfield River in Shelburne and Buckland; and (4) the Chicopee River hydroelectric system, consisting of the Red Bridge (4.5 MW), Putts Bridge (4.1 MW), Dwight (1.7 MW), and Indian Orchard (3.7 MW) hydroelectric facilities located on the Chicopee River in Hampden and Hampshire Counties (Exh. WMECo-1, at 8).

WMECo states that the sale of these Assets to CEEI involves the following agreements: (1) Purchase and Sale Agreement ("PSA"); (2) Assignment and Assumption Agreement; (3) Interconnection and Operation Agreement; (4) Asset Demarcation Agreement; (5) Generation Support Services Agreement; and (6) Buyer's Easement (id. at 10-11).

#### B. Review of The Sale Process

##### 1. Description

WMECo states that its strategy was to use a two-stage competitive auction process to market its Assets (id. at 9). The Company indicates that J.P. Morgan Securities, Inc. ("J.P. Morgan") was retained to assist WMECo in the development and implementation of this strategy (Exh. WMECo-3, at 2).<sup>(4)</sup>

Roger H. Wood, Vice President for the Natural Resources and Power Group of J.P. Morgan, and J.P. Morgan's representative in this divestiture, states that the first phase of WMECo's auction ("Phase 1") involved the identification of potential buyers, an evaluation of each potential buyer's pre-qualifications to participate in the auction, and an invitation for pre-qualified buyers to submit a non-binding bid (id. at 3-4).

According to WMECo, J.P. Morgan compiled a list of 180 potential buyers using (1) trade publications and other external industry sources, and (2) information internal to J.P. Morgan such as clients and other entities (Exh. DTE-1-12). Further, WMECo states that certain local players were added to this list based on Northeast Utilities' ("NU") and J.P. Morgan's awareness of local activities (id.).<sup>(5)</sup> Mr. Wood indicates that an announcement letter was sent to the 180 potential buyers at the same time that a statement was issued to newspapers and trade publications (Exh. WMECo-3, at 4). The

announcement letter described the Assets and requested that parties indicate their interest (id. at 4). Mr. Wood notes that, of the 180 potential buyers, 60 expressed interest (id. at 6).

Mr. Wood explains that all responses to the announcement letter, as well as any inquiries regarding the sale process, were directed to J.P. Morgan (id. at 5).<sup>(6)</sup> Mr. Wood asserts that during Phase 1 all prospective bidders were provided with the responses to questions asked by any prospective bidder (Exh. AG-1-16).

According to the Company, interested parties were required to sign a confidentiality agreement and to agree to a pre-qualification review before receiving any further information about the Assets (Exh. WMECo-3, at 4). Mr. Wood states that J.P. Morgan evaluated the pre-qualifications of interested parties to ensure that only serious bidders were allowed to participate in the auction process (Exh. AG-1-10). Mr. Wood notes that parties known to J.P. Morgan were also evaluated based on J.P. Morgan's knowledge of them (id.). According to Mr. Wood, parties unknown to J.P. Morgan were required to describe their company, management, level of relevant experience, and financial capabilities (id.). Mr. Wood explains that of the 60 interested parties, 37 signed the confidentiality agreements and underwent J.P. Morgan's pre-qualification review (Exh. WMECo-3, at 6). Of those 37 parties, 35 were pre-qualified by J.P. Morgan (id.).<sup>(7)</sup>

The Company states that pre-qualified bidders were provided access to a data room that contained plant-specific information including maps of the property, historical and forecasted operational and financial information, environmental reports, and technical operating data (id.). In addition, Mr. Wood asserts that J.P. Morgan established a website for bidders (id.). Mr. Wood maintains that J.P. Morgan coordinated visits to the data room, and that J.P. Morgan also arranged to have copies of selected documents from the data room sent to bidders (id.). According to Mr. Wood, of the 35 pre-qualified bidders, 27 of these visited or requested information from the data room (id.).

Pre-qualified bidders, according to WMECo, were informed that in submitting a non-binding bid, J.P. Morgan would require the following information: (1) a financial plan; (2) an operating plan; (3) a due diligence plan; (4) a statement of acceptance regarding labor agreements; and (5) a list of required regulatory and board approvals (id. at 4-5). Based on that information and their non-binding bid price, WMECo asserts that J.P. Morgan determined whether a pre-qualified bidder would be qualified to complete the sale (id. at 5). Mr. Wood contends that qualified bidders received additional information, including a confidential Descriptive Memorandum which described the auction process and the Assets in detail (id. at 5-6).

Mr. Wood asserts that on October 5, 1998, J.P. Morgan received a number of non-binding bids from prospective buyers (id. at 11). Mr. Wood explains that J.P. Morgan evaluated each bid and summarized its key aspects (id.). Mr. Wood also explains that on October 8, 1998, J.P. Morgan, Ropes & Gray (WMECo's counsel for the auction), WMECo's Auction Officer, and WMECo's Project Manager met to review J.P. Morgan's analysis (id.). According to Mr. Wood, the group decided that each entire-portfolio bidder

would be advised that it could bid a single price for the entire portfolio, and that if it wished to bid on only the fossil assets or the hydro assets, it could do so (id. at 12). Further, Mr. Wood states that this approach would allow WMECo to compare the best entire-portfolio bid with the sum of the best fossil and best hydro bids (id.).

Mr. Wood contended that in mid-October, 1998, after the foregoing evaluation process, J.P. Morgan invited a short-list of bidders to make binding bids in the second phase ("Phase 2") of WMECo's auction (id.).<sup>(8)</sup> Mr. Wood states that J.P. Morgan contacted each short-listed bidder to schedule site visits, data room visits, and meetings with management (id.; Exh. AG-1-15). According to Mr. Wood, J.P. Morgan worked with WMECo and Ropes & Gray to develop the PSA and other agreements involved with the sale, and that such agreements were provided to the short-listed bidders for comment (Exh. WMECo-13).

Mr. Wood asserts that during Phase 2, documents that were pertinent to all bidders were distributed to all bidders (Exh. AG-1-16). However, to ensure the integrity of a Phase 2 bidder's competitive position, responses to questions of a strategic nature asked by a specific bidder were provided to that bidder only (id.).

Mr. Wood states that on December 7, 1998, J.P. Morgan received binding bids from the short-listed bidders (Exh. WMECo-3, at 13).<sup>(9)</sup> According to Mr. Wood, J.P. Morgan alone reviewed the financial aspects of the bids, and Ropes & Gray reviewed proposed changes to the PSA (id.). Mr. Wood contends that Phase 2 bids were evaluated primarily with respect to price, terms and conditions, and the feasibility of closing in an expeditious manner (id.).

On December 9, 1998, according to Mr. Wood, representatives of J.P. Morgan and Ropes & Gray met with WMECo's Auction Officer and WMECo's Project Manager to review the results of the binding bids (Exh. WMECo-3, at 13). Mr. Wood states that it was the consensus that one bid would clearly yield the highest price if terms of the sale could be successfully negotiated (id. at 14). According to Mr. Wood, a decision was made to commence negotiations with that bidder, and only after that decision was made was the identity of the high bidder, CEEL, revealed to WMECo's Auction Officer and WMECo's Project Manager (id. at 14). Mr. Wood asserts that for purposes of undertaking final negotiations with the high bidder, CEEL's identity was also disclosed to WMECo's Vice President - Fossil/Hydro Engineering and Operations; WMECo's Vice President - Environmental, Safety and Ethics; an Assistant General Counsel, and a Senior Counsel (id. at 9).

## 2. Analysis and Findings

In evaluating WMECo's divestiture of the Assets, the Department first reviews the sale process to determine whether it was equitable and whether it was structured to maximize the value of the assets being sold. In making these determinations, the Department considers whether the Company used a "competitive auction or sale" that ensured "complete, uninhibited, non-discriminatory access to all data and information by any and

all interested parties seeking to participate in such auction or sale." G.L. c. 164, § 1A(b)(2).

The Department notes that the Company employed an auction that consisted of two major phases. The Department notes that most of the Company's auction process was implemented and overseen by J.P. Morgan, a third-party hired for that purpose, and that each phase of the Company's auction involved many potential bidders. Because the Company's auction process was supervised by a third-party, because the auction process involved many potential bidders, and because the auction process was comprehensive and systematic, the Department finds that the Company used a competitive auction in the sale of its Assets.

The Department notes that prospective bidders were provided with access to a data room and website, as well as site visits, responses to specific questions, and discussions with management. In addition, the record indicates that J.P. Morgan provided generic information to all prospective bidders in both phases of the Company's auction, reserving only strategic information and reserving that only in Phase 2. The Department notes that no party has indicated any concern with respect to the management of or access to information. Based on the foregoing, the Department finds that the Company ensured complete, uninhibited, non-discriminatory access to all data and information by any and all interested parties seeking to participate in its auction.

Because the Department has found that the Company has used a competitive auction that ensured complete, uninhibited, non-discriminatory access to all data and information by any and all interested parties seeking to participate in such auction, the Department finds that the Company's sale process was equitable and was structured to maximize the value of the assets being sold.

### 3. Maximization of Asset Value

#### a. Description

WMECo proposes to sell its Assets at a sales price of about 3.8 times the book value estimated as of December 31, 1998 (Exh. WMECo-1, at 7). WMECo contends that CEEI will pay \$47 million for the Assets, with certain adjustments, on the closing date of the sale (id. at 11). According to WMECo, this sale price is subject to adjustment to account for, among other things, (1) fuel, parts, and supply inventories, and (2) certain expenditures incurred during the period between the date of signing the PSA and the closing date (id.)<sup>(10)</sup>.

The Company states that CEEI will assume all environmental responsibilities with respect to the Assets (Exh. WMECo-1, at 13). However, WMECo states it will retain remediation responsibility associated with certain environmental conditions identified by the Company's environmental consultant, and is obligated to fund up to \$2 million for remediation of certain environmental conditions identified during testing performed at CEEI's request (id. at 14).



The Company stated that its customers would benefit from the sale of the Assets because (1) CEEMI is a wholly-owned subsidiary of CEEI, which, in turn is a wholly-owned subsidiary of Consolidated Edison Company of New York, a large, financially sound regulated utility with solid experience in operating generating facilities; (2) the net proceeds of the sale would reduce WMECo's stranded costs and therefore, its transition charge; and (3) the sale would promote competition among generators thereby facilitating lower energy costs for customers (Tr. at 6; Exh. AG-1-33). In addition, the Company asserts that the selection of CEEI was based first and foremost on bid price (Exh. AG-1-26).

#### b. Analysis and Findings

In evaluating WMECo's divestiture of the Assets, the Department determines whether the value of the Assets was maximized. The Department notes that WMECo plans to sell these Assets at a price of about 3.8 times the Assets' estimated book value. This price falls in the middle of book values approved in other divestitures. The Department has noted that the sale price for Massachusetts Electric Company and Boston Edison Company was about one and a half times the book value in their asset divestitures. Cambridge Electric Light Company, Commonwealth Electric Company and Canal Electric Company, D.T.E. 98-78/83, at 11 (1998). The sale price for Cambridge Electric Company, Commonwealth Electric Company and Canal Electric Company ("COM/Elec") was about six times the book value in their asset divestiture. Id. In addition, the purchaser of WMECo's Assets submitted the highest bid price in a competitive auction. Accordingly, based on the foregoing, the Department finds that the value of the Assets was maximized.

#### 4. Consistency with Company's Plan and Restructuring Act

In evaluating WMECo's divestiture of the Assets, the Department determines whether the divestiture transaction is consistent with the Company's restructuring plan and with the Restructuring Act.<sup>(11)</sup> Because the Department has found (1) that the Company's sale process is equitable and structured to maximize value, and (2) that the value of the Company's Assets has been maximized, the Department finds that the Company's divestiture transaction is consistent with the Company's restructuring plan and consistent with the Restructuring Act.

#### 5. Designation of Generating Assets as Exempt Wholesale Generators

WMECo states that in accordance with the regulations of the Securities and Exchange Commission ("SEC"), assets to be sold that have previously been in rate base of a retail company cannot be sold and retain EWG status by the buyer unless the ratemaking jurisdiction approves and makes certain specified findings (Tr. at 33-34; WMECo Brief at 8, citing 15 U.S.C.A. § 79z-5a(c)). Accordingly, WMECo requests that the Department designate the Assets as facilities eligible to be EWGs pursuant to the Public Utility Holding Company Act of 1935 ("PUHCA"), 15 U.S.C.A. § 79z-5a (Petition at 7; WMECO Brief at 8).<sup>(12)</sup> The Company contends that in order for CEEMI to obtain EWG



status, specific state determinations are required, namely that allowing the facilities to be eligible facilities (1) will benefit customers, (2) is in the public interest, and (3) does not violate state law (id.; WMECo Brief at 9, citing 15 U.S.C.A. § 79z-5a(c)).

According to WMECo, obtaining EWG status for the facilities is a condition precedent to the closing of the sale of WMECo's Assets to CEEI (id.; WMECO Brief at 8; Tr. at 33). WMECo states without EWG status, few entities would have been willing to bid for the Assets, and the purchase price realized by WMECo would have been greatly reduced (WMECo Brief at 8). WMECo further states that by obtaining the highest competitive price for the facilities, the Company has maximized mitigation of its transition costs (id. at 9-10). Furthermore, WMECo claims that the entry of CEEI into the generation market will advance the goal of competition contemplated by the Restructuring Act (id. at 10).

First, based on the fact that the expectation of eligible status underlies the purchase price of the facilities, and this price mitigates transition costs to be paid by ratepayers, and also because timely action will avoid administrative costs that would similarly be borne by ratepayers, the Department finds that the designation of the requested facilities as eligible facilities will benefit customers. Second, because it will benefit customers and the record does not contain any evidence suggesting that it will harm the public interest in any way, the Department finds that it is in the public interest. Third, since this divestiture is undertaken in order to comply with the Restructuring Act, and competing wholesale generators, including EWGs, will be an integral part of the competitive generation industry that the Restructuring Act was designed to enable, the Department finds that the designation of the requested facilities as eligible facilities does not violate state law, but rather, furthers the objectives of the state law. Accordingly, for the above reasons, the Department approves the designation as eligible facilities, as defined in PUHCA, for West Springfield, Doreen Street and Woodland Road, Gardner's Falls, Red Bridge, Putt's Bridge, Dwight, and Indian Orchard because such designation (1) will benefit customers, (2) is in the public interest, and (3) does not violate state law.

#### IV. ORDER

Accordingly, after due notice, hearing and consideration, it is hereby

ORDERED: That the Asset Divestiture involving the sale by Western Massachusetts Electric Company of the West Springfield, Doreen Street and Woodland Road, Gardner's Falls, Red Bridge, Putt's Bridge, Dwight, and Indian Orchard facilities, as embodied in the Purchase and Sale Agreement and other related documents, to Consolidated Edison Energy Massachusetts, Inc. is approved; and it is

FURTHER ORDERED: That the facilities West Springfield, Doreen Street and Woodland Road, Gardner's Falls, Red Bridge, Putt's Bridge, Dwight, and Indian Orchard are eligible facilities as defined in PUHCA; and it is

FURTHER ORDERED: That Western Massachusetts Electric Company comply with all orders and directives contained herein.

By Order of the Department,

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Janet Gail Besser, Chair

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James Connelly, Commissioner

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W. Robert Keating, Commissioner

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Paul B. Vasington, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

Appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part.

Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. (Sec. 5, Chapter 25, G.L. Ter. Ed., as most recently amended by Chapter 485 of the Acts of 1971).